#131, 26 November, 2001

A publication of the International Centre for Policy Studies

ICPS newsletter

Growth expected despite risky environment

A new issue of ICPS's Quarterly Predictions journal will be published next week. We forecast that in 2001, the gross domestic product (GDP) of Ukraine will increase by 8%. In 2002, Ukraine's economic growth rate will slow to 4.5%; however, it will again speed up, to 6% in 2003. These economic trends are influenced by a variety of factors-on the one hand, the global economic slowdown, and on the other hand, continued growth of domestic demand

Economic activity

Over the first three quarters of 2001, the GDP of Ukraine has increased by 9.3% y-o-y. Such a positive change was triggered by accelerated growth in construction and in agriculture. Meantime, the same indicator in industry persisted in its decline, primarily due to restrictions of export opportunities.

We forecast that by year-end the GDP will increase by 8%. We have decreased our forecast for Ukraine's economic growth in 2002, to 4.5%. However, in 2003 this indicator will again rebound, to 6%.

Our pessimistic estimates apply mostly to the foreign trade forecast, where the trade balance will go into the red already in Q4'01. In 2002, this indicator will continue to deteriorate, owing to decelerated export growth. The forecast for foreign economic activity in 2002 is based on the following assumptions:

• deteriorating conditions in the global economy; we have reduced our 2002 forecast for GDP growth of Ukraine's trade partners by 70 basis points, to 3.3%;

• intensification of anti-dumping measures in developed countries and, likewise, in CIS countries, as a reaction to the slowing economy;

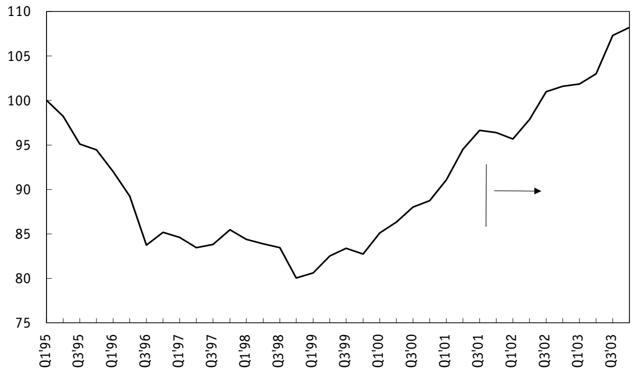
• real revaluation of the hryvnia in 2000-2001, which will affect the conduct of Ukrainian exporters in 2002.

In 2003, the export growth rate will increase, thanks to the revived global economy. According to our forecast, the GDP of Ukraine's trade partners will increase by 3.8% in 2003. Nevertheless, Ukraine's foreign trade balance in 2003 will again be negative, with imports steadily increasing in both 2002 and 2003 and prevailing over exports.

Russia and other CIS countries are quite likely to maintain a high growth rate. These economies have begun to flourish recently and possess a considerable unrealised potential; therefore, the global economic downturn will affect these regions only slightly. The situation of Ukrainian exporters in these markets may turn out to be better than we expect, which represents a positive opportunity for the Ukrainian economy.

Figure Real GDP

Index [Q1'95=100], seasonally adjusted



Source: State Statistics Committee; forecast by Quarterly Predictions.

The increased domestic demand will allow the Ukrainian economy to compensate to some extent for a slowed export growth rate. Household consumption will serve as a strong impetus boosting domestic demand. For the time being, though, we forecast slower growth in investment for 2002.

It was primarily the lack of a consistent state policy regarding infrastructure sectors that induced us to revise our forecast. We consider a common problem of these sectors to be ineffective management, i.e., the limited influence of private owners, and the government's failure to set long-term development objectives for these sectors and to monitor their execution. In the transport industry, state authorities perform both economic and managerial functions, which leads to abuses of power and redirection of state funds to the private sector. The government's support of vested interests of industrial enterprises is manifested in delaying the adoption of decisions to raise tariffs on electricity; under these circumstances, enterprises in the sector will incur losses. The situation in the telecoms sector has turned out to be comparatively better, thanks to intensified competition. However, the sector has problems because of the lack of coordinated rules regulating interaction between market agents. The absence of reforms in the above sectors poses a threat to overall economic development. Finally, inefficient allocation of resources in the healthcare system reduces the quality and accessibility of medical services; this casts a shadow on the quality of economic growth in Ukraine.

Investment in 2002 will also be hampered by the following circumstances: (1) decreased profits of exporting enterprises, which will limit investment sources; (2) generally pessimistic attitudes among enterprise managers, due to noticeably deteriorated foreign market conditions. Our forecast for increased investment growth in 2003 is based on the probable reduction of direct taxes after the adoption of the Tax Code.

Household consumption will continue to increase rapidly. The survey conducted by the International Centre for Policy Studies together with the GfK-USM company reveals that consumer confidence improved again during Q3'01, with the average-income bracket being the most optimistic. Given the positive opinion of these most active consumers, we can anticipate increased demand. Moreover, the survey identifies a strengthening trend among consumers to make large purchases.

Ukraine's agriculture is getting on a fast growth track. As previously, demand for agricultural produce from the food industry, and directly from citizens, will be quite large. Agricultural productivity will increase, with an influx of investments to the sector. The increased profits of farmers and the enhanced appeal of this sector for banks will attract more investments, as will the adoption of the Land Code, which stipulates that land can now be collateralised.

Financial stability

The trade balance will drop into the negative and will affect the exchange rate trend in the currency market, i.e., the hryvnia will depreciate, albeit insignificantly. The prospects for Ukraine's economic growth will stimulate the influx of foreign capital, especially, during the privatisation process. Meantime, renewed hryvnia devaluation after two years of stability may provoke greater fluctuation of the currency exchange rate.

Among the factors determining the low inflation rate in 2002-2003, the major ones will be a slower rate of money emission, maintaining a low budget deficit, and an economic upturn. Over this period, price shocks may occur from increased tariffs in the infrastructure sectors.

These developments of the nominal exchange rate and of consumer inflation will assure the stability of the hryvnia real exchange rate. And hence, the purchasing power of the Ukrainian currency will remain largely unchanged, compared to other monetary units.

The main hazard to financial stability in Ukraine will be the possibility of a bigger budget deficit. In 2002, a disbalance may be triggered by the dependency of budget execution on privatisation, and by a worse economic dynamic than that estimated in the budget. In 2003, the Tax Code implementation will lead to decreased tax revenues; meanwhile, the government may not be able to concomitantly reduce expenditures. ■

If you wish to receive ICPS publication set, please contact Yevhenia Yehorova, phone: (380-44) 463-6337 or forward a request with your contact information to: marketing@icps.kiev.ua

Major indicators

	2000	2001 (estimate)	2002 (forecast)	2003 (forecast)
Economic activity				
GDP, millions UAH	172952	203800	228300	258900
Real GDP, apc*	5.8	8.0	4.5	6.0
Real industrial production, apc	12.9	14.0	6.0	9.0
Real agricultural output, apc	7.6	10.0	6.0	5.0
Gross investment, % GDP	18.6	20.6	21.7	23.0
FDI, millions USD (1)	594	900	1100	1100
Real household disposable incomes, apc	11.1	10.5	7.0	8.0
Real retail trade, apc	7.5	9.5	6.5	6.0
Prices				
Consumer price index, apc	26	6	8	6
Producer price index, apc	21	2	6	7
Labour market				
Population, millions	49.3	49.1	48.9	48.7
Real wage, average apc	1.0	9.0	3.5	4.5
Official unemployment rate, %	4.2	4	4.5	5.5
Foreign economic activity				
Exports of goods & services, apc	20.3	10.0	3.5	5.5
Imports of goods & services, apc	18.9	15.0	8.0	6.0
Current account balance, % GDP	4.7	2.4	-0.3	-0.7
Budget				
Revenues (consolidated), % GDP (2)	28.4	25.6	24.4	23.8
Current balance, % GDP	0.4	0.2	0.5	0.2
Balance by IMF methodology, % GDP	-1.1	-1.1	-1.6	-1.0
Monetary indicators				
Monetary base, apc	39	33	17	14
M3, apc	45	34	19	16
NBU international reserves, millions USD	1539	2550	2840	3200
Official exchange rate average annual, UAH/USD	5.44	5.38	5.63	5.85
Interest rate on loans, average annual, yearly %(3)	41	32	28	25
International				
World GDP, apc	4.7	1.6	1.7	2.8
GDP of Ukraine's major trading partners (2/3 of exports), apc	6.0	2.6	3.1	3.7

** apc = annual percentage change*

Notes:

(1) according to NBU;

(2) calculated by the iMF methology since 2001;

(3) commercial banks loans, UAN

Sources: State Statistics Committee, NBU, and Finance Ministry; calculations and forecast by Quarterly Predictions.

ICPS Newsletter is a weekly publication of the International Centre for Policy Studies delivered by electronic mail. To be included in the distribution list mail to: marketing@icps.kiev.ua.
ICPS Newsletter editor Maria Melnyk (mmelnyk@icps.kiev.ua)
English text editor D. (Ksenia) Ovcharenko.

The International Centre for Policy Studies is an independent non-profit research organisation with the objective of improving the Ukrainian policy development process.
Address: 8/5 Voloska Street, Kyiv 04070, Ukraine
Phone (380-44) 462-4937/38/48. Fax (380-44) 463-5970
Web-site: http://www.icps.kiev.ua